

Three Tier System Review Panel Meeting

November 19, 1998 - 2 p.m.
State Capital Campus, Olympia
John L. O'Brien Building, Hearing Room E

Minutes

1. The following persons introduced the themselves:

- Frank Warnke, Distilled Spirits Council of the United States
- Brian Young, Distillery Representatives Association of Washington
- Patty Genova, Distillery Representatives Association of Washington
- Jack Quinn, Distillery Representatives Association of Washington
- Carol Owens, Governor's Council on Substance Abuse
- Peter Dow
- Bob Gault, Licensed Beverage Association
- Kit Hawkins, Restaurant Association of Washington
- Mark Jenson, Safeway, representing Washington Retail Association
- Phil Wayt, Washington Beer and Wine Wholesalers Association
- Dave Cammarano, Cammarano Bros. Distributing, representing Washington Beer and Wine Wholesalers Association

DEFENDANT'S EXHIBIT

CASE
NO. C04-0360P

EXHIBIT
NO. 531

2. Nate Ford, Chairman of the Washington State Liquor Control Board, introduced the meeting.

Chairman Ford thanked the panel members for agreeing to serve on the three tier review panel meeting. He stated the Board cannot possibly accommodate everyone who would like to be on this panel and still keep it to a workable group. Those who are not on the panel from whom the Board needs information, opinion, and history perspectives will be given other opportunities for involvement.

Chairman Ford stated the Board is not asking for a re-analysis of the underlying premise of the three tier system. However, the agency is mindful of the appearance in the legislature each year of limited exception to the system associated with changes in the way modern corporations are organized. Chairman Ford stated the Board would like the panel members' help to understand what can be done to make unnecessary constant changes in the statutes associated with the organization of the modern business world.

Chairman Ford indicated the Board is also mindful that the three tier system is the source of some of the rules and regulations that are adopted and enforced by the Board. Following the direction of Governor Locke, the agency is reviewing its regulatory system with the intent of making it more simple, more user friendly, and easier and more economical to administer. Therefore, the Board hopes the panel can make recommendations about the regulatory framework that will achieve these objectives.

Chairman Ford stated the Board is aware of the increasing convenience and utilization of the Internet for retailing. He indicated there is a tendency for this type of commerce to completely bypass the regulatory structure. Chairman Ford stated the Board will anxiously await whatever recommendations the panel can design that will help Washington maintain the framework that it has fashioned for the regulation of the distribution of alcohol while adjusting to the new world of electronic commerce.

Chairman Ford stated the Board has asked Bill Daley, Director of the Policy, Legislative, and Media Relations Division, to be the temporary chair of the panel in order to get things going. He indicated the Board will continue to explore options for a permanent chair.

Finally, Chairman Ford stated the panel is free to devise its own schedule; however, the Board asks that the panel have its recommendations to the agency by mid-august of 1999. He stated the board will give great weight to whatever recommendations are provided, and they would like some time to consider the recommendations before the agency fashions its legislative agenda for the year 2000 session.

3. Norman Clark, author of *The Dry Years - Prohibition and Social Change in Washington*

Chairman Ford introduced Norman Clark, author of *The Dry Years - Prohibition and Social Change in Washington*. Chairman Ford stated this book is arguably the foremost study on the history of alcohol in the United States and particularly in Washington State.

Mr. Clark stated the movement to get rid of saloons and ultimately to bring prohibition to the country has a long history. There was a movement in the 1830s that put a lot of states dry, at least temporarily, until the issue of wet vs. dry came up in during the Civil War. After the Civil War the dries picked up again and they began working methodically toward what ultimately became in 1920 prohibition.

Mr. Clark explained by the time Washington State was organized, the prohibition movement was strong enough so that the framers of the constitution put it on the ballot. The people voted in 1889 whether or not to accept the constitution, and also whether or not to accept an amendment to the constitution providing prohibition for alcoholic beverages. The dries lost but did not slow down, and after 1889 the movement focused on what ultimately would be called the "local option law." This was an effort to bring to new towns and cities that had arrived with the railroads the option of licensing or refusing to license a saloon. The local option law was implemented in 1909, and immediately dozens of cities decided to take the local option.

Mr. Clark stated in 1912 the constitution was amended to allow for direct legislation through the initiative and referendum processes. In 1914 the first initiative on the ballot was the anti-saloon initiative, which prohibited the manufacture and sale of alcoholic beverages in the state of Washington. Mr. Clark stated the initiative didn't say you couldn't drink; rather it prohibited the licensing of saloons. Someone who wished to drink could order alcohol by mail from other states for personal consumption. In 1916

the issue was again on the ballot, and the people voted even more overwhelmingly against saloons than they had in 1914.

Mr. Clark stated the key to understanding this issue is to find out what was so bad about the saloon. He indicated you must consider the pre-industrial saloon, before the railroads came. As late as the 1880s, the saloon was still a benign, neighborhood institution. They were places where people respected fellowship, recreation, and social life, and where most wage-earners spent a great deal of their time. Drunkenness, violence, etc. were really not a problem.

The railroads brought with them thousands of people into the cities and towns. Also with the railroads came refrigerated cars. Previously, the unpasteurized beer had to be kept on ice, so the saloon territory was limited to the distance that a horse-drawn wagon could hold the iced beer. Therefore, there weren't many saloons that a brewery could service.

The advent of pasteurization, the Crown bottle cap, and refrigerated railroad cars allowed the breweries to ship anywhere. Each brewery took a keen interest in controlling as many saloons as possible. The way to gain an exclusive outlet for their product was to provide capitalization for saloons, in exchange for the saloon's promise to deal exclusively with the brewer's product. Fierce competition ensued, and if one saloon became involved in illegal business such as prostitution or narcotics, the others would follow in order to compete and to pay bills to the brewers. Associated with these events was the pollution of political life, and early on the saloon keepers and brewers discovered they could buy legislators and votes.

In 1917, following the overwhelming defeat of the saloons the year before, congress dried up the military, making it illegal to sell liquor to anyone in uniform. In 1918 the voters passed what was called the "bone dry" initiative, which prohibited the importation of liquor. In 1919 congress passed the 18th amendment, and in 1920 prohibition began.

Mr. Clark stated prohibition was impossible to enforce. There was no way to prevent "rum running", the illegal importation of alcohol, so there were bootleggers in every city. People became frustrated when enforcement didn't work, and society itself began to change. Individualism became more important in American life. Thus, by 1932 people were eager to dump the prohibition system.

In 1933, Washington voters met to elect delegates to a repeal convention. After repeal, power was given back to the states. The legislature was called into special session two days after repeal became effective. The question before the legislature was, "what do we do now?" The answer was to make the sale and consumption of alcoholic beverages legal again, but not to allow the return of the saloon. The Steele Act created a state monopoly for the sale of hard liquor, and severely regulated the sale of beer and wine. What was remembered with this act was that the driving engine behind saloons had been the financial interest that brewers and distillers had in saloons. Washington's

three tier system came out of the deep-seated conviction that there should be no inter-relationship between alcohol manufactures, distributors, or retailers.

Mr. Clark stated the regulations passed by the newly-created Liquor Control Board were extremely severe, all directed toward encouraging temperance, prohibiting drunkenness and violence, and basically prohibiting anything that even looked like a saloon. The state liquor stores were designed to encourage temperance in sometimes severe ways, including a requirement that you had to have a permit to buy liquor. The liquor store clerks were prohibited from giving product information or recommendations.

Mr. Clark indicated things have changed greatly since that time with the loosening of many regulations. Two significant changes were the advent of the liquor-by-the-drink initiative in 1948 and the California Wine Bill in 1967, which allowed wholesalers to buy wine directly from wineries and sell it directly to retailers.

4. Kim O'Neal, Assistant Attorney General

Ms. O'Neal reviewed the attached worksheet, which outlines RCW 66.28.010, known as the Tied House statute. The worksheet delineates the major prohibitions, which include prohibitions against:

- any financial interests between the three tiers,
- a manufacturer or distributor owning any property on which a retail licensee conducts business,
- any manufacturer, importer, or distributor advancing money or moneys worth to a retail licensee,
- any manufacturer, importer, or distributor holding any kind of a retail license.

Ms. O'Neal stated all of these prohibitions were in place by 1937. She indicated the remainder of the worksheet outlines all of the exceptions that have been made to these major prohibitions since that time (see attached).

5. Dave Dunbar from the Bureau of Alcohol, Tobacco, and Firearms (BATF)

Mr. Dunbar stated BATF is responsible for enforcing laws, and these federal laws do not address the three tier system. BATF enforces three laws relating to the production and marketing of alcoholic beverages. One is the imposition of a tax upon all three tiers of the system. When a business fills out this taxation form they are also registering themselves with the BATF. The second is a law passed after the 21st Amendment, known as the Web-Kenyan Act. Simply stated, this act makes it illegal to ship alcohol to a state in violation of the laws of that state. The law carries no penalty.

Mr. Dunbar stated the third law enforced by BATF is the Federal Alcohol Administration Act. This act established a permit system and instituted trade practice legislation. The permit system requires all producers (except brewers), wholesalers, and importers to obtain a permit from BATF. Mr. Dunbar explained if a person applies for a permit, BATF must issue the permit (the law states "shall" issue), unless the applicant has been

convicted of a felony in the last five years, or of a misdemeanor under any federal law relating to alcohol in the last three years. The Federal Alcohol Administration Act conditions a permit on the compliance with the 21st amendment and the state law relating to its enforcement.

Mr. Dunbar emphasized that nothing in this permit system prohibits a person from engaging in all three tiers of the system. The Federal Alcohol Administration Act has four major prohibitions:

- exclusive outlets,
- a "tied house" induced in certain ways,
- consignment sales, and
- commercial bribery.

In making comment upon these four prohibitions, testimony before the Committee of Ways and Means in part states, "The foregoing practices have in this industry constituted the principal abuses whereby interstate and foreign commerce have been restrained and monopolistic control has been accomplished or attempted. Furthermore, such abuses were so prevalent before prohibition that they were regarded in large measure as responsible for the evils that lead to prohibition."

Mr. Dunbar explained section 205B of the Federal Alcohol Administration Act states that it is illegal for a manufacturer, importer, or wholesaler to induce a retailer to purchase their products to the exclusion of similar products offered by sale by others in interstate commerce, by holding any interest in the retail licensee. A subsequent section states that the outright ownership of a retail business by a manufacturer, importer, or wholesaler is not an interest that can result in a violation of the act. However, partial ownership can result in a violation, as partial ownership of a retailer is deemed to be practice which puts retailer independence at risk.

6. Chairman Ford stated the Board asks that the panel formulate recommendations in the following three areas:

- Should legislation be considered that would better accommodate the three tier structure to the contemporary corporate world?
- What changes, if any, should be made to simplify the rules and regulations of the Washington State Liquor Control Board associated with the three tier system? How can the expense and time involved in the regulation of these separate tiers be reduced?
- Are there any changes in three tier system associated law or rule that should be considered because of the impact of emerging new technologies on the structures of corporations or on other business practices? Are there changes in state rule or law that should be considered given the emergence of electronic retailing systems that cross state and national boundaries?

7. Next meeting

Bill Daley, Director of Policy, Legislative, and Media Relations, presented a proposed agenda for the next meeting on December 10. He suggested that Dave Goyette, Director of Licensing and Regulation, discuss the Board's rules and policies regarding the three tier system.

For future meetings, Mr. Daley stated the Board will invite persons who are not panel members but have expressed an interest in the process to address the three subjects outlined by Chairman Ford. Experts will also speak to the panel about electronic commerce as it relates to the three tier system.

The meeting was adjourned at 3:41 p.m.

PROHIBITIONS

No manufacturer, importer or distributor *OR PERSON FINANCIALLY INTERESTED DIRECTLY OR INDIRECTLY IN SUCH BUSINESS WHETHER RESIDENT OR NONRESIDENT* shall have any financial interest direct or indirect, in any licensed retail business.

No manufacturer, importer or distributor shall own any of the property upon which retail licensee conducts business. No retail licensee shall conduct business upon property in which manufacturer, importer or distributor has any interest

No manufacturer, importer or distributor shall advance moneys or moneys' worth to a retail licensee under an arrangement, nor shall a retail licensee receive, under an arrangement, an advance of moneys or moneys worth.

No manufacturer, importer or distributor shall be eligible to receive or hold a retail license nor shall such manufacturer, importer or distributor sell at retail any liquor.

Financial interest, direct or indirect, as used in this section, shall include any interest, whether by stock ownership, mortgage, lien, or through interlocking directors, or otherwise.

Financial Interest Exceptions

No manufacturer, importer or distributor or person financially interested directly or indirectly in such business whether resident or nonresident shall have any financial interest direct or indirect in any licensed retail business

(added in 1998)

unless the retail business is owned by a corporation in which a manufacturer or importer has no direct stock ownership and there are no interlocking officers and directors, the retail license is held by a corporation that is not owned directly or indirectly by a manufacturer or importer, the sales of liquor are incidental to the primary activity of operating the property as a hotel, alcoholic beverages produced by the manufacturer or importer or their subsidiaries are not sold at the licensed premises, and the board reviews the ownership and proposed method of operation of all involved entities and determines that there will not be an unacceptable level of control or undue influence over the operation or the retail licensee

Added in 1985 to permit someone to sell a wholesale business on a contract

A person holding rights to payment from selling a liquor wholesaler's business and transferring the license shall not be deemed to have a financial interest under this section if the person (i) lacks any ownership in or control of the wholesaler, (ii) is not employed by the wholesaler, and (iii) does not influence or attempt to influence liquor purchases by retail liquor licensees from the wholesaler

Added in 1975

Provided, that nothing in this section shall prohibit a retail licensee, or any person financially interested, directly or indirectly in such a retail licensee from having a financial interest, direct or indirect, in a business which provides, for a compensation commensurate in value to the services provided, bottling, canning or other services to a manufacturer, so long as the retail licensee or person interested therein has no direct financial interest in or control of said manufacturer.

Property Ownership Exceptions

No manufacturer, importer or distributor shall own any of the property upon which retail licensee conducts business. No retail licensee shall conduct business upon property in which manufacturer, importer or distributor has any interest.

Added in 1996 for the Gorge Amphitheatre

unless title to that property is owned by a corporation in which a manufacturer has no direct stock ownership and there are no interlocking officers or directors, the retail license is held by a corporation that is not owned directly or indirectly by the manufacturer, the sales of liquor are incidental to the primary activity of operating the property either as a hotel or as an amphitheater offering live musical and similar live entertainment activities to the public, alcoholic beverages produced by the manufacturer or any of its subsidiaries are not sold at the licensed premises and the board reviews the ownership and proposed method of operation of all involved entities and determines that there will not be an unacceptable level of control or undue influence over the operation of the retail licensee.

Baronsky Legal File
BAR000000000435

Money's Worth Exceptions

No manufacturer, importer or distributor shall advance moneys or moneys' worth to a retail licensee under an arrangement, nor shall a retail licensee receive, under an arrangement, an advance of moneys or moneys worth

added in 1982 to allow banks to hold mortgages of wholesalers, manufacturers and retailers

provided that "person" as used in this section only shall not include those state or federally chartered banks, state or federally chartered savings and loan associations, state or federally chartered mutual savings banks, or institutional investors which are not controlled directly or indirectly by a manufacturer, importer or wholesaler as long as the bank, savings and loan association, or institutional investor does not influence or attempt to influence the purchasing practices of the retailer with respect to alcoholic beverages.

Added in 1975

pursuant to rules promulgated by the board in accordance with chapter 34.05 RCW manufacturers, wholesalers and importers may perform and retailers may accept the service of building, rotating and restocking case displays and stock room inventories; rotating and rearranging can and bottle displays of their own products; provide point of sale material and brand signs; price case goods of their own brands; and perform such similar normal business services as the board may by regulation prescribe

Added in 1975 and further amended in 1982 to allow the services to special occasion licenses

This section does not prohibit a manufacturer, importer or wholesaler from providing services to a special occasion licensee for: (i) installation of draft beer dispensing equipment or advertising, (ii) advertising, pouring or dispensing of beer or wine at a beer or wine tasting exhibition or judging event or (iii) a special occasion licensee from receiving any such services as may be provided by a manufacturer, importer or wholesaler

RCW 66.28.042 - passed in 1990

A liquor manufacturer, importer, or wholesaler may provide to licensed retailers and their employees food and beverages for consumption at a meeting at which the primary purpose is the discussion of business, and may provide local ground transportation to and from such meetings. The value of the food, beverage, or transportation provided under this section shall not be considered the advancement of moneys or moneys' worth within the meaning of RCW 66.28.010.

RCW 66.28.043 - passed in 1990

A liquor manufacturer, importer, or wholesaler may provide to licensed retailers and their employees tickets or admission fees for athletic events or other forms of entertainment occurring within the state of Washington, if the manufacturer, importer, wholesaler, or any of their employees accompanies the licensed retailer or its employees to the event. A liquor manufacturer, importer, or wholesaler may also provide to licensed retailers and their employees food and transportation to and from activities allowed under this section. The value of the food, beverage, transportation, or admission to events provided under this section shall not be considered the advancement of moneys or moneys' worth within the meaning of RCW 66.28.080.

RCW 66.28.190 - added in 1988

RCW 66.28.010 notwithstanding, persons licensed as wholesalers may sell at wholesale nonliquor food products on thirty-day credit terms to persons licensed as retailers under this title, but complete and separate accounting records shall be maintained on all sales of nonliquor food products to ensure that such persons are in compliance with RCW 66.28.010.

Baronsky Legal File
BAR000000000437

Licensing Exceptions

No manufacturer, importer or distributor shall be eligible to receive or hold a retail license nor shall such manufacturer, importer or distributor sell at retail any liquor.

Added in 1975 to allow for breweries and wineries to sell products of their own manufacture

Nothing in this section shall prohibit a licensed domestic brewery or microbrewery from being licensed as a retailer for the purpose of selling beer or wine at retail on the brewery premises and nothing in this section shall prohibit a domestic winery from being licensed as a retailer for the purpose of selling beer or wine at retail on the winery premises. . . . beer and wine that is not produced by the brewery or winery shall be purchased from a licensed beer or wine distributor.

Added in 1977 to allow the Olympia Brewery to own the class H restaurant located on brewery property at Tumwater Valley Golf Club and to allow Ste. Michelle Winery to locate a class H restaurant at their Woodinville property

Nothing in this section shall prohibit a licensed domestic brewery, microbrewery, domestic winery or a lessee of a licensed domestic brewery, or domestic winery, from being licensed as a spirits, beer and wine restaurant for the purpose of selling liquor at a spirits, beer and wine restaurant premises on the property on which the primary manufacturing facility of the licensed domestic brewer, microbrewery or domestic winery is located or on contiguous property owned by the licensed domestic brewer, or domestic winery as prescribed by rules adopted by the board.

Added in 1985 to allow Anheuser-Busch to purchase and operate Exploration Cruise Lines

A license issued under RCW 66.24.395 does not constitute a retail license for the purposes of this section

Added in 1996 when the brewpub license was adopted

A public house license does not violate the provisions of this section as to a retailer having an interest directly or indirectly in a liquor licensed manufacturer.

Brewpub license carries restrictions such as:
may manufacture no more than 2,400 barrels
may sell only at retail on the licensed premises for consumption on the licensed premises
may not hold a wholesaler's or importer's license or act as agent of another manufacturer, wholesaler or importer or hold a brewery or winery license

Latest exception allows a public house having been in bus at least 6 mos to become a brewery (or winery)